

**STATE OF NORTH DAKOTA
BISMARCK, NORTH DAKOTA**

REPORT OF EXAMINATION

OF

**FARMERS MUTUAL INSURANCE
COMPANY OF TRAILL COUNTY
PORTLAND, NORTH DAKOTA**

**AS OF
DECEMBER 31, 2003**

STATE OF NORTH DAKOTA
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Farmers Mutual Insurance Company of Traill County

Portland, North Dakota

as of December 31, 2003, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official seal at my
office in the City of Bismarck, this _____ day of
_____, 2004.

Jim Poolman
Commissioner of Insurance

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Portland, North Dakota
August 25, 2004

Honorable Jim Poolman
Commissioner of Insurance
North Dakota Insurance Department
600 East Boulevard Avenue
Bismarck, ND 58505-0320

Dear Sir:

Pursuant to your instructions and in accordance with the North Dakota Insurance Code and resolutions adopted by the National Association of Insurance Commissioners, an examination was made of the books, records, and financial condition of

Farmers Mutual Insurance Company of Traill County

Portland, North Dakota

as of December 31, 2003.

INTRODUCTION

Farmers Mutual Insurance Company of Traill County, Portland, North Dakota, hereinafter referred to as the "Company," was last examined as of December 31, 1996, by representatives of the State of North Dakota.

SCOPE OF EXAMINATION

The current examination covers the period January 1, 1997, through December 31, 2003, including any material transactions and events occurring subsequent to the examination date and noted during the course of this examination.

This examination was made in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners with due regard to the statutory requirements of the insurance laws, rules, and regulations of the State of North Dakota.

Examination procedures included a verification and evaluation of assets, a determination of liabilities, and reviews of corporate records, claim files, and other records relating to Company operational practices.

All recommendations made in the prior report of statutory examination have been adequately addressed by the Company with the following exceptions:

Recommendations	Action by Company
It is recommended that the Company report the excess of book value over market value of a stock as a non-admitted asset.	The Company did not report the excess of book value over market value of stock as a non-admitted asset in the annual statements for years 2000 through 2003 .
It is recommended that the Company include a provision for reinsurance recoverable in its computation of unpaid loss reserves.	The Company did not reduce unpaid losses for the expected reinsurance recoverable of an unpaid claim.

HISTORY

The Company was incorporated on June 22, 1885, as The Farmers Mutual Fire and Lightning Insurance Company of Traill County by virtue of an act of the legislature of the Territory of Dakota, approved March 13, 1885. The Company commenced business on June 23, 1885.

The Company's term of existence was originally established for 30 years. The Articles and Bylaws were subsequently amended in accordance with N.D. Cent. Code § 26.1-13-03 making the Company's existence perpetual.

The Company was organized for the specific purpose of mutually insuring the property of its members against any risk of hazard by fire, lightning, and limited extended coverage.

The Company may insure all such property as prescribed under N.D. Cent. Code Chapter 26.1-13 and as may be approved by the Board of Directors. In 1964, the Company began writing windstorm coverage.

At the annual meeting held on June 29, 1969, the Company voted to adopt new Articles of Incorporation and Bylaws and changing its name to the "Farmers Mutual Insurance Company of Traill County."

MANAGEMENT AND CONTROL

The Company is controlled by its membership. Any person owning property within the limits of the territory within which the Company is authorized to transact business may become a member of the Company and be entitled to all the rights and privileges accorded each member. No person who does not reside within such territorial limits shall become a director of the Company.

Directors

The management of the Company's affairs, business, and property is vested in a Board of Directors composed of seven members elected for staggered terms of three years each at the annual meeting of the membership. A majority of the entire Board of Directors constitutes a quorum for the transaction of business.

Directors duly elected and serving the Company at December 31, 2003, were as follows:

Name and Residence	Term Expires
Paul C. Moen Mayville, ND	2006
Ronald Peterson Buxton, ND	2007
George F. Vettel Cummings, ND	2007
Frank Harrington Hillsboro, ND	2005
Orland Niemeier Buxton, ND	2005
Gerald Radebaugh Grandin, ND	2006
Dan Thompson Clifford, ND	2007

Officers

Officers are elected annually by the Board of Directors at the first meeting of the Board of Directors held after each annual meeting. Officers serving at December 31, 2003, were as follows:

<u>Name</u>	<u>Office</u>
Paul C. Moen	President
George F. Vettel	Vice President
Karter K. Krogh	Secretary and Treasurer

Executive Committee

The Company's records do not reflect any activity by the Executive Committee during the period under review.

CORPORATE RECORDS

The minutes of the meetings held by the membership and directors during the years under examination were reviewed for compliance with the Articles of Incorporation, Bylaws, and statutory requirements.

The following amendments to the Articles of Incorporation and Bylaws were approved by the membership during the period under review:

Articles: At the April 28, 1997 annual policyholder meeting, Article VI was amended to change the number of directors from nine to seven. The annual meeting date was also changed from the last Saturday in June to the first Monday in April.

Bylaws: At the April 3, 2000 annual policyholder meeting, Section 2 was amended to provide that the annual meeting will be held on the first Monday in April.

Members

During the period under examination the annual meetings of the policyholders were held on the following dates: April 28, 1997; April 6, 1998; April 5, 1999; April 3, 2000; April 2, 2001; April 1, 2002 and April 7, 2003.

Directors

During the period under examination the Board of Directors held six regular meetings in 1997, five in 1998, six in 1999, six in 2000, six in 2001, three in 2002, and four in 2003.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2003, there was in force a continuous position schedule fidelity bond covering the Secretary-Treasurer and the President for the faithful performance of duty in the amount of \$10,000 each. This coverage does not meet the minimum amount of fidelity insurance recommended in the NAIC's *Financial Examiners Handbook* which is \$25,000. During the course of this examination, the Company raised the amount of the fidelity bond to the amount required by the NAIC.

The Company also had in force a directors and officers liability insurance policy providing a \$1,000,000 limit of liability each policy year. Each claim is subject to a \$5,000 deductible. The policy provides coverage for errors or omissions in the performance of professional services and wrongful acts of a director or officer while acting solely in their individual or collective capacities as directors and officers.

Insurance coverage on the Company's home office building was reviewed and appeared to be adequate.

The Company paid the premium for an agent's liability insurance policy covering the Secretary-Treasurer in his role as an agent for the Company.

TERRITORY AND PLAN OF OPERATION

At December 31, 2003, the Company had 24 licensed agencies and was authorized to transact business within all of Traill, Cass, Steele, Griggs, Foster, Eddy, Stutsman, Barnes, Ramsey, Ransom and Grand Forks Counties.

SIGNIFICANT OPERATING RESULTS

Growth

The following exhibit reflects the growth of the Company over a 10-year period ending December 31, 2003. The data is compiled from home office copies of the filed Annual Statements, except for the years 1996 and 2003 which reflect the result of examination. The operational results are presented on a cash basis.

Year	Admitted Assets	Total Liabilities	Surplus as Regards Policyholders	Net Premiums Written	Underwriting Deductions	Investments and Other Income	Net Income (Loss)
1994	\$488,408	\$260,033	\$228,375	\$266,058	\$330,774	\$38,440	\$(26,277)
1995	483,282	245,479	237,803	277,656	288,748	46,596	35,504
1996	504,653	302,797	201,856	266,467	289,597	43,601	20,471
1997	380,450	232,128	148,323	264,662	430,144	25,939	(139,543)
1998	446,901	270,814	176,087	290,531	243,157	30,566	77,940
1999	375,076	218,214	156,862	250,399	350,482	28,425	(71,658)
2000	443,006	253,581	189,425	283,999	287,246	25,561	22,314
2001	396,614	263,041	133,573	282,730	374,311	33,785	(57,796)
2002	433,813	234,858	198,955	298,282	238,003	26,274	86,553
2003	531,218	267,388	263,830	278,168	243,194	70,487	105,461

Operating Ratios

The underwriting ratios presented below are on a cash basis and encompass the seven-year period ending December 31, 2003.

	1997	1998	1999	2000	2001	2002	2003
Premiums	100%	100%	100%	100%	100%	100%	100%
Deductions:							
Losses and Loss Adjustment	92%	23%	71%	39%	71%	19%	26%
Underwriting Expenses	71%	61%	69%	62%	62%	60%	61%
Total Deductions	163%	84%	140%	101%	133%	79%	87%
Net Underwriting Gain (Loss)	-63%	16%	-40%	-1%	-33%	21%	13%

MARKET CONDUCT ACTIVITY

Treatment of Policyholders

Claims Based on a limited review of claim files, the Company appears to pay claims fairly within policy provisions upon receipt of satisfactory proof of loss or damage.

Advertising The Company's use of advertising is minimal.

REINSURANCE

The Company ceded reinsurance under a reinsurance treaty with Grinnell Mutual Reinsurance Company during the years under examination. This nonaffiliated ceding contract consists of individual occurrence of loss and aggregate excess as summarized below.

Type:	Excess								
Reinsurer:	Grinnell Mutual Reinsurance Company								
Scope:	Fire, Lightning and Extended Coverage: (A) Individual Occurrence of Loss Excess - Covers all risks written by the Company in excess of \$50,000 retention subject to the following limits: <table><tr><td>Dwelling</td><td>\$ 500,000</td></tr><tr><td>Farm Outbuildings</td><td>750,000</td></tr><tr><td>Livestock Operations</td><td>500,000</td></tr><tr><td>Commercial and Public Property</td><td>500,000</td></tr></table> (B) Aggregate Excess - Provides coverage for 100 percent of the Company's aggregate net loss in excess of a defined retention limit. The retention limit for 2003 was \$212,857.	Dwelling	\$ 500,000	Farm Outbuildings	750,000	Livestock Operations	500,000	Commercial and Public Property	500,000
Dwelling	\$ 500,000								
Farm Outbuildings	750,000								
Livestock Operations	500,000								
Commercial and Public Property	500,000								
Premium:	(A) Individual Occurrence of Loss Excess - The 2003 annual premium was \$.0395 per \$1,000 of adjusted gross fire risks in force at the end of each month during the contract year. (B) Aggregate Excess - The 2003 annual premium was \$.0542 per \$1,000 of gross fire risks in force at the end of each month during the contract year.								
Commissions:	None								
Termination Date:	The agreement may be terminated only as of the last day of any calendar year by either party upon 90 days notice in writing.								

The contract contains the insolvency clause required by N.D. Cent. Code § 26.1-02-21 and all of the clauses required by the NAIC *Accounting Practices and Procedures Manual* except for the "entire contract" clause. **It is recommended that the Company amend its reinsurance**

agreement with Grinnell Mutual Reinsurance Company to include an “entire contract” clause.

ACCOUNTS AND RECORDS

The accounts and records of the Company are on a cash basis and consist of a cash receipts journal, a cash disbursement journal, a claims register, a policy register, and a corporate record book.

A trial balance was prepared as of December 31, 2003, for the purpose of tracing it to the Annual Statement and other tests of the accounting records were conducted during the course of this examination to determine if the annual statement was completed in accordance with *Annual Statement Instructions*. The following exceptions were noted:

Section II, Income Received, Page 2 – Liability premiums received from policyholders of Grinnell Mutual Reinsurance Company, net of the liability premiums remitted to Grinnell, should be reported as Write-In Income (i.e., line 10). The Company incorrectly classified liability premiums remitted to Grinnell as “premiums for reinsurance ceded to other companies” (line 1c) which amounts should only included ceded premiums on the Company’s direct business written.

Section II, Disbursements, Page 2 – Federal unemployment tax should be classified and reported under payroll taxes (line 30) rather than federal income taxes (line 31).

Section IV, Ledger Assets, Page 3 – A checking account balance is incorrectly classified and reported as “Cash on deposit” (line 6) rather than “checking accounts” on line 5.

Section VII – Parts 1 and 2, Page 4

- Cusip numbers for each security were not provided in the description column.
- Interest and dividends due and accrued were not reported.

Section VII – Parts 3 and 4, Page 5

- The full purchase date (month and day) of bonds was not reported in column 2.
- Accrued interest paid for purchased bonds was incorrectly included in the “cost to company” (column 5) rather than reported in column 7.

Section A – Part 1, Page 10

- An amount for rent relating to the company’s occupancy of its own building was not reported in column 10. The total of column 10 must agree with page 2, line 5.
- Amounts for real estate taxes paid, real estate expenses including depreciation, and rent items were not reported in column 11. The total of column 11 must agree with the sum of page 2, lines 25, 26, and 27.

It is recommended that the Company thoroughly review the *Annual Statement Instructions* to insure that its annual statement is completed in compliance with those instructions.

In the course of performing audit procedures, the Examiner considered internal controls, noting the following exceptions:

- The Company required only one signature for checks issued.
- The Company does not prohibit issuing checks to “cash.”
- Checks received are not restrictively endorsed upon receipt.

It is recommended that the Company require two signatures on all checks, or on all checks in excess of a minimum amount established by the Board; that the Company prohibit issuing checks to “cash” and that checks be stamped with a restrictive endorsement when received.

FINANCIAL STATEMENTS

The financial statements section includes the following:

Statement of Assets, Liabilities, and Surplus as of December 31, 2003

Statement of Cash Receipts and Cash Disbursements for the Year of 2003

Farmers Mutual Insurance Company of Traill County
Statement of Assets, Liabilities, and Surplus
as of December 31, 2003

ASSETS

LEDGER ASSETS

Bonds	\$ 95,347.41
Stocks	243,579.01
Real Estate	6,076.92
Checking Account	125,998.51
Cash on Deposit	56,128.89
Furniture and Fixtures	<u>3,068.50</u>

TOTAL LEDGER ASSETS	\$530,199.24
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NON LEDGER ASSETS

Interest Due and Accrued Bonds	\$ 241.59
Reinsurance Recoverable on Paid Losses	<u>3,946.20</u>

TOTAL NON LEDGER ASSETS	4187.79
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DEDUCT: ASSETS NOT ADMITTED

Furniture and Fixtures	\$ 3,068.50
Excess of Book Value Over Market Value	<u>100.29</u>

TOTAL NONADMITTED ASSETS	<u>3,168.79</u>
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TOTAL NET ADMITTED ASSETS	<u><u>\$531,218.24</u></u>
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LIABILITIES

Unpaid Losses	\$ 4,380.42
Unpaid Loss Adjustment Expenses	1,100.00
Unearned Premium	189,537.45
Commissions Due to Agents	2,585.25
Unpaid Taxes	5,441.87
Unpaid General Expenses	1,052.58
Interest Due on Borrowed Money	185.65
Reinsurance Premiums Due and Payable	13,105.35
All Other Liabilities (Loan)	<u>50,000.00</u>

TOTAL LIABILITIES	\$267,388.57
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SURPLUS TO POLICYHOLDERS	<u>263,829.67</u>
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TOTAL LIABILITIES AND SURPLUS	<u><u>\$531,218.24</u></u>
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Farmers Mutual Insurance Company of Traill County
Statement of Cash Receipts and Cash Disbursements
for the Year 2003

INCOME		
Gross Premium Income	\$430,620.12	
Less: Return Premiums	12,598.25	
Premiums for Reinsurance Ceded	<u>139,853.90</u>	
NET PREMIUM INCOME		\$278,167.97
Interest on Bonds		7,028.23
Dividends on Stocks		4,986.13
Gross Rent from Company Property (Including \$2,400 for Company Occupancy)		2,400.00
Profit on Sale or Maturity of Ledger Assets		(76.86)
Service Fees		6,149.19
Money Borrowed During Year		<u>50,000.00</u>
TOTAL INCOME RECEIPTS		\$348,654.66
DISBURSEMENTS		
Gross Losses Paid and Incurred in 2003	\$78,165.67	
Gross Losses Paid in 2003 But Incurred In Prior Years	9,816.87	
Deduct: Reinsurance Recovered	14,418.49	
Subrogation	0.00	
Salvage	<u>2,500.00</u>	
NET LOSSES PAID		\$71,064.05
Claim Adjustment Expenses		2,389.92
Commissions Paid to Agents		82,073.06
Directors Fees and Expenses		3,180.20
Salaries to Employees		30,977.00
Printing, Stationary, and Office Supplies		932.83
Rent and Rent Items (Including \$2,400 for Company Occupancy)	2,486.00	
Real Estate Expenses		3,080.10
Taxes on Real Estate		925.79
State and Local Insurance Taxes		5,438.00
Insurance Department Licenses and Fees		320.00
Payroll Taxes		6,483.18
Unemployment tax		112.00
Legal Fees and Auditing		2,350.00
Travel and Travel Items		5,091.87
Advertising		19.07
Dues and Donations		3,282.41
Equipment		1,038.59
Insurance and bonds		4,400.34
Postage, Telephone, and Bank Charges		3,727.52
Employee Relations and Welfare		9,735.10
Data Processing		2,117.03
Meeting Expense		1,670.01
Merrill Lynch Management Fee		<u>300.00</u>
TOTAL FUNDS DISBURSED		<u>243,194.07</u>
NET GAIN (LOSS)		<u>\$ 105,460.59</u>

COMMENTS TO THE FINANCIAL STATEMENTS

Financial statement balances at December 31, 2003, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Real Estate

\$6,076.92

The Company's investment in real estate consists of a home office building, with attached garage, located on Lots 1, 2, and 3, Block 1, Riverside Addition, Portland, North Dakota. The building is a modern, one story, frame structure house with a full basement. The house is divided to provide office space for the Company, consisting of one large room and a walk-in fireproof vault. The remainder of the building is provided to the Secretary-Treasurer rent free as a residence. The Company pays 100 percent of the monthly bills for electricity, fuel oil for heat, water and sewer, and telephone relating to the entire dwelling.

Interest Due and Accrued on Bonds

\$241.59

The Company did not report any interest due or accrued on bonds at December 31, 2003. This examination determined the amount to be \$241.59.

Reinsurance Recoverable on Paid Losses

\$3,946.20

Reinsurance recoverable on paid losses was determined by this examination to be \$3,946.20 or \$165.00 less than the amount reported by the Company. The variance reflects an estimated amount for reinsurance recoverable on unpaid losses that was incorrectly included in the amount reported by the Company under this caption.

Excess of Book Value Over Market Value

\$100.29

The excess of book value over market value of stock of \$100.29 is required to be reported as a non-admitted asset. **It is again recommended that the excess of book value over market value be classified as a non-admitted asset.**

Unpaid Losses

\$4,380.42

This examination determined the liability for unpaid losses to be \$4,380.42 or \$1,235.00 more than that reported by the Company. The components included in the examiner's calculation are as follows:

Unpaid claims at 12/31/2003	\$4,145.42
Incurred but not reported (IBNR) provision	400.00
Less: Reinsurance recoverable on unpaid losses	<u>(165.00)</u>
Unpaid Losses	\$4,380.42

The Company did not include a reserve for incurred but not reported losses and did not deduct reinsurance recoverable on unpaid losses in computing unpaid losses. **It is recommended that the Company follow the *Annual Statement Instructions* for reporting the liability for unpaid losses by including an estimate for incurred but not reported losses and deducting any potential reinsurance recoverable on unpaid losses.**

Unearned Premium Reserve

\$189,537.45

The liability for unearned premium reserve at year end was determined by this examination to be in the amount of \$189,537.45 or \$832.45 more than that estimated by the Company.

Commissions Due and Payable to Agents

\$2,585.25

The liability for commissions due and payable to agents was determined by this examination to be in the amount of \$2,585.25 or \$2,585.25 more than that estimated by the Company.

Unpaid General Expenses

\$1,052.58

Invoices and other evidence of indebtedness were reviewed for expenses incurred prior to year end but paid subsequent to year end. The liability for unpaid general expenses was determined by this examination to be in the amount of \$1,052.58 or \$502.58 more than that estimated by the Company.

Surplus to Policyholders

\$263,829.67

Surplus to policyholders was determined by this examination to be in the amount of \$263,829.67 or \$5,178.98 less than the amount reported by the Company. Adjustments to surplus are shown in the following schedule:

Caption	Company	Examination	Surplus Increase or (Decrease)
Non-Ledger Assets			
Interest Due and Accrued on Bonds	\$ 0	\$ 241.59	\$ 241.59
Reinsurance Recoverable on Paid Losses	4,111.20	3,946.20	(165.00)
Non-Admitted Assets			
Excess of Book Value Over Market Value	0	100.29	(100.29)
Liabilities			
Unpaid Losses	3,145.42	4,380.42	(1,235.00)
Unearned Premium Reserve	188,705.00	189,537.45	(832.45)
Commissions Due to Agents	0	2,585.25	(2,585.25)
Unpaid General Expenses	550.00	1,052.58	<u>(502.58)</u>

Net Change in Surplus

\$(5,178.98)

CONCLUSION

The financial condition of Farmers Mutual Insurance Company of Traill County, Portland, North Dakota, as determined by this examination as of December 31, 2003, is summarized as follows:

TOTAL ADMITTED ASSETS	<u>\$531,218.24</u>
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Total Liabilities	\$267,388.57
Surplus to Policyholders	<u>263,829.67</u>

TOTAL LIABILITIES AND SURPLUS	<u>\$531,218.24</u>
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Since the last examination, conducted as of December 31, 1996, the Company's admitted assets have increased \$26,565, its total liabilities have decreased \$35,409, and its surplus to policyholders has increased \$61,974.

The examination was performed by Rhoda M. Sautner, Insurance Department Examiner, who noted the courteous cooperation extended her during the course of this examination.

Respectfully submitted,

Carole Kessel, CPA
Chief Examiner
N.D. Insurance Department

COMMENTS AND RECOMMENDATIONS

- Page 6 It is recommended that the Company amend its reinsurance agreement with Grinnell Mutual Reinsurance Company to include an “entire contract” clause.
- Page 7 It is recommended that the Company thoroughly review the *Annual Statement Instructions* to insure that its annual statement is completed in compliance with those instructions.
- Page 8 It is recommended that the Company require two signatures on all checks, or on all checks in excess of a minimum amount established by the Board, that the Company prohibit issuing checks to “cash” and that checks be stamped with a restrictive endorsement when received.
- Page 11 It is again recommended that the excess of book value over market value be classified as a non-admitted asset.
- Page 11 It is recommended that the Company follow the *Annual Statement Instructions* for reporting the liability for unpaid losses by including an estimate for incurred but not reported losses and deducting any potential reinsurance recoverable on unpaid losses.